International Journal of Business
Management & Research (IJBMR)
ISSN(P): 2249-6920; ISSN(E): 2249-8036
Vol. 5, Issue 2, Apr 2015, 95-106

OUTSOURCING STRATEGY AND THE PERFORMANCE OF CHEVRON NIGERIA LIMITED

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ABSTRACT

Despite the belief that outsourcing strategy has been at the core of managerial practice and literature for a long time, authors do not agree on a clear understanding of the nature of its effect on firm’s performance. This study therefore explored the long-term effect of outsourcing strategy on organization profitability of Chevron Nigeria Plc over a period of 15 years. Exploratory research design was employed. Data were analyzed using Pearson’s correlation coefficient and the findings from the test of hypothesis revealed that outsourcing strategy has a positive effect on organisational profitability. This implies that the use of outsourcing strategy in an organization enhances the profitability of the organization. The study recommended that organization should embrace the outsourcing strategy in order to cut cost, increase profitability and productivity.

KEYWORDS: Outsourcing Strategy, Chevron Nigeria Plc, Hypothesis Revealed

INTRODUCTION

Background of the Study

In today’s world of ever increasing competition, organizations are forced to look for new ways to generate value. Globalization of practices driven by accelerated competition among manufacturing and service delivery organizations has pushed firms to create value for money through efficient use of limited resources. One avenue that organizations have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these organizations (Quinn, 2000). Outsourcing is a management strategy by which an organization delegates major, non-core business functions to specialized and efficient service providers (Corbett, 2005). Outsourcing business operations and processes is usually inevitable in instances where a specific firm has no knowledge or skills for performing the task within the organization. Besides, company can also outsourced in order to minimize workload, attain financial economies, increase ability to focus on core competencies and strategic issues, access to technology and specialized expertise, ability to demand measurable and improved service levels, and achieve competitive advantage. As Grossman and Helpman (2005) state; ‘’ we live in an age of outsourcing". The reasons for the onset of this “age of outsourcing" lie in what Baldwin (2006) refers to as globalization’s second unbundling". He defines the first unbundling as being marked by industrialisation, trade, growth, urbanization and increasing internal inequality. The phenomenon however, appears to have entered into a new stage with outsourcing of services becoming increasingly important. This change in structure has been underway for some time, and is generally attributed to the interplay between three factors: technological advances, economic and competitive pressures to reduce costs (Quinn, 2000), improve productivity (Casale, 2006), and institutional developments favouring trade liberalisation. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such

changes mean that organizations must focus on their core competencies and capabilities (McIvor, 2008).

Many studies recall the idea that the adoption of an outsourcing strategy could be related to the growing pressure on management to remain competitive by “accomplishing more with less”. Achieving efficiency, effectiveness, and consequently greater productivity through strategies such as restructuring, downsizing, and reengineering activities (Insinga & Werle, 2000) are all results that could eventually contribute to the achievement and sustainability of competitive advantage (Gilley & Rasheed, 2000) and overall firm performance (Rothaermel, Hitts & Jobe, 2006). While outsourcing has been used to create a competitive advantage within many service sectors, be it a tactic (cost) or strategic (broader) advantage (Rodríguez & Padrón-Robaina, 2004), several studies have shown that Multinational companies never realize the full benefits of outsourcing as they have encounter many problems such as supplier opportunism, which ultimately can result in downstream market competition (Lim & Tan, 2010), lower service standards due to the learning cost curve (Hennart, 2007), cost cutting leading to a decreased service level and finally different expectations, as Gellings and Wullenweber (2006) put it, often company expectations are not congruent leading up to an increase in friction between both the outsourcing company and its outsourced company. Proponents of outsourcing continue to argue that the phenomenon has long-term economic benefits, and that it eventually will increase living standards through positive profitability effects and reductions in factor costs. The effects of outsourcing on firms’ performance are not completely clear. Previous outsourcing studies show contradictory results; while some claim a positive relationship between outsourcing and performance outcomes, others report no significant or even negative effects (Rothaermel & Deeds, 2001). It is against this background that this study evaluates the effect of outsourcing management strategy on the performance of multinational corporations in Nigeria using chevron Nigeria limited as a case study.

STATEMENT OF THE PROBLEM

Over the past decades there is a growing realization of the important contribution of outsourcing strategy on organizational performance (Cousins, Lawson & Squire 2006). In 2000, the global outsourcing market was estimated to be worth about $232 billion, this already amounted up to $443 billion in 2008 (Newton-Taylor 2010). A study of Nigeria Unilever Plc and Nestle Nigeria Plc (Adeyemi & Ibrahim, 2012) reported a significant and positive effect of outsourcing strategy on an organizational profitability. Indeed, it is difficult to find an industry or a firm that does not take part in the outsourcing trend. Yet, the popularity of outsourcing does not imply that every firm benefits from outsourcing (Barthélemy, 2003). A study on the effect of outsourcing strategy in telecommunications firms in Nigeria reported a negative effect on organization’s profitability due to poor service delivery, poor network quality, low coverage level and increasing customer complaints (Rothaermel & Deeds, 2001). Dun and Bradstreet’s Barometer of Global Outsourcing (2000) reports that outsourcing arrangements are characterized by unexpected high failure rates. Within the first two years of the arrangement, almost 25 percent of all arrangements fail, and within five years the failure rate increases up to 50 percent. Similarly, KPMG (2007) indicates that only 42 percent of 659 surveyed firms indicated that outsourcing had improved their performance. The increasing use of outsourcing arrangements, as well as the unfamiliar complexity associated with it especially in developing countries suggests the need to probe further on its effect on organisational profitability.

OBJECTIVE OF THE STUDY

The broad objective of the study is to explore the effect of outsourcing strategy on the performance of Chevron

Nigeria Limited. Specifically, the study intends to determine the nature of the effect of outsourcing strategy on the profitability of Chevron Nigeria Limited.

RESEARCH QUESTION

- What is the nature of the effect of outsourcing strategy on the profitability of Chevron Nigeria Limited?

HYPOTHESIS

Specifically the hypothesis is stated as:

- H_o: There is no nature of effect of outsourcing strategy on the profitability of Chevron Nigeria Limited.
- H_i: There is nature of effect of outsourcing strategy on the profitability of Chevron Nigeria Limited.

REVIEW OF RELATED LITERATURE

Conceptual Review

Dwindling resources and market competitiveness have forced organizations to scrutinize their methods of producing goods and services and make changes in their processes in order to maximize economic returns. Outsourcing is promoted as one of the most powerful trends in modern management (Brannemo, 2006). Outsourcing is an abbreviation for *"outside resource using"* (Arnold, 2000). However, in general, outsourcing has been defined in many different ways; Eyaa *(2006*), defined outsourcing as a decision by firms to have an external supplier to take over an activity that would have otherwise been performed in-house by organization employees. Linder (2004) defined outsourcing as purchasing goods or services from outside companies "*that a company currently provides, or most organizations normally provide for themselves''*. According to Beaumont (2006), outsourcing can be said to be one subtype of distributed work. It is the delegation of task or job from internal production to external entity, such as a subcontractor. Smith *et al*, (2006) defined outsourcing as turning over to a supplier those activities outside the organization's chosen core competencies. Usually organizations look for the best service providers to whom to outsource their work, this gives them a chance to get their work done by experts which means good quality work leading to a good company name. Outsourcing differs from alliances, partnerships or joint ventures in that the flow of resources is one-way, from the vendor to the outsourcer; typically, profit sharing or mutual contribution are not a common practice (Belcourt, 2006). McIvor, (2008) asserted that outsourcing has become an important business approach, and competitive advantage may be gained as products or services are produced more effectively and efficiently by outside suppliers. Lee and Kim, (2010) have argued that outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and strategically use outside vendors to perform service activities that traditionally have been internal functions. Outsourcing can also involve the transfer of both people and physical assets to the supplier (McIvor, 2008). Frayer et al, (2000) have suggested that multinational companies are increasingly viewing outsourcing strategies as a means of reducing costs, improving operating efficiency increasing quality, and enhancing a firms overall competitive position. As companies seek to enhance their competitive positions in an increasingly global marketplace, they are discovering that they can cut costs and maintain quality by relying more on outside service providers for activities viewed as supplementary to their core businesses.

Outsourcing is not a new concept. The first systematic and scientific research of outsourcing can be found in the late 80's and early 90's of the last century (Ford and Farmer 1986; Due, 1992; Willcocks and Lacity, 1995 etc.). Thorough

scientific studies of the effect and importance of outsourcing are still rare. Experts in this area (Corbett, 2004; Jensen, 2007) claim that the phenomenon of outsourcing gained so much importance over the last twenty years due to global social change and transformation as well as the booming public sectors worldwide. Firms already started outsourcing in the 1970s, with a major wave of outsourcing starting in the early 1990s (Hätönen and Eriksson 2009). However, the nature of the functions being outsourced is changing radically. Traditionally, outsourcing was restricted to activities like distribution and support activities, like payroll services and human resources, today firms are increasingly outsourcing strategic functions that are relatively more crucial to their business (Gottfredson, Puryear, and Phillips 2005; Katz 2006), such as new product development and front-end processes like IT and customer support.

THEORETICAL FRAMEWORK

The productivity-enhancing effect of outsourcing can be explained theoretically using the Agency theory by Jensen, M. 1994, & W. Meckling, 1976 and transaction cost theory (TCT) by Ang &Straub, 1998.

As a company makes the decision to outsource, it has by definition also chosen to do business with another company as well. This division normally leads to what Jensen and Meckling (1976) and many others (Fama, 1980, Bitler & Moskowitz, 2005) further described as the agency theory. The above mentioned theory suggests that the firm and its surroundings can be viewed as an interconnected web of resource holders. Within these resource holders, agency theory arises when the principal agent hires another resource holder, the agent, to perform a service and thereby delegating some authority to an agent. The agency theory suggests that outsourcing will increase productivity as it limits opportunism and self-serving behaviour on behalf of employees. In this context, output can be better controlled and inefficiencies minimized through a contract than within the boundaries of the firm, so outsourcing is chosen for its productivity enhancing effects.

The transaction cost theory as developed by Williamson are costs related to the effort, time, and costs associated with searching, creating, negotiating, monitoring, and enforcing a service contract between buyers and suppliers. As per Williamson, there are two types of costs involved for any service–production costs, and coordination cost. Production cost is the cost incurred to make the product or to provide the service. It includes the cost of labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If these costs are outweighed by the savings from specialization which outsourcing offers, then a firm will decide to outsource.

EMPIRICAL REVIEW OF THE EFFECT OF OUTSOURCING MANAGEMENT STRATEGY ON ORGANIZATIONAL PROFITABILITY

Outsourcing and its profitability effect is a growing research topic. Evidence on the relationship between outsourcing and profitability growth is not conclusive. In an early study, Siegel and Griliches (1992), in assessing whether outsourcing leads to an overstatement of manufacturing profitability growth, find a weak correlation in the use of selected purchased services during the 1980s. Meanwhile, Ten Raa and Wolff (2001) find a positive association between the rate of outsourcing and profitability growth in the goods sector. Amiti and Wei (2006) find that both service outsourcing and material outsourcing have a positive and significant effect on profitability in the U.S. and that the effect of service outsourcing is greater in magnitude. Görzig and Stephan (2002) analyze the impact of outsourcing on the firm level performance of German manufacturing firms in the period between 1992 and 2000 using a large dataset of 43,000 firm-year observations. They use three proxies to capture the degree of outsourcing of the firms: material inputs over labor

cost, representing the “make or buy”-type of outsourcing, external contract work over labor costs as proxy for the outsourcing of production functions, and external services over labor costs. They can show that all three types of outsourcing lead to better performance in terms of return per employee. On the other hand, only increased material input has a positive influence on overall firm performance measured as return over sales while services outsourcing has a negative effect. Görg and Hanley (2004) analyze the effects of outsourcing, measured by total bought inputs over value add in the plant, on the profitability of 215 plants in the Irish electronics industry between 1990 and 1995. Distinguishing service outsourcing and material outsourcing, they find that only large plants profit from material outsourcing while they can derive no clear-cut results for service outsourcing. Girma and Görg (2004) study the determinants for outsourcing as well as the impact of outsourcing on firm productivity using panel data from UK firms in the manufacturing industry between 1980 and 1992. They use the value of industrial services received over total labor costs of the firms as a proxy for outsourcing intensity. They find that outsourcing intensity is positively related to labor productivity and total factor productivity only in the chemical and engineering sector, while it has no influence on the firms in the electronics sector. similarly, a study by Narigisi (2008) on the impact of outsourcing on organizational performance in Century Bottling Company Limited revealed that outsourcing positively increases on the performance of organizations, that is to say, it reduces on costs, increase access to new technology, new expertise, core competence concentration, speed up delivery and increase revenue / profits. Gilley and Rasheed (2000) analyze the influence of the outsourcing of core and peripherical functions on firm performance considering the moderating effects of firm strategy and environmental dynamism. They collected subjective data on firm performance relative to peers and outsourcing intensity from 94 manufacturing firms. The results of this study show no direct impact of outsourcing on firm performance. However, outsourcing is positively related to the performance of firms which pursue cost leadership and innovation differentiation strategies. Jiang, Frazier and Prater (2006) study the effects of outsourcing on the firm level performance measures of 51 large US firms based on audited accounting data in a period from 1990-2002 and they find improved cost efficiency but no change in the productivity and profitability of the outsourcing firms

Prior research has extensively studied the outsourcing of routine processes, like support activities, distribution, and human resources (e.g, Gilley, Greer, and Rasheed 2004; Tiwana 2008). In contrast, the outsourcing of more strategic, less routine functions, such as information technology and new product development, has received little attention in the literature. As Jiang, Frazier, and Prater (2006,) note, “in an age in which management carefully weighs the costs and benefits of every discretionary investment dollar, finding evidence of the results of outsourcing is critical.” although academic studies have provided valuable insights into the drivers of the outsourcing decision, surprisingly little empirical research exist on the performance implications of this decision (Leiblein, Reuer, and Dalsace 2002). Moreover, the research that has studied the performance outcomes of outsourcing is inconclusive. Whereas some studies find a positive relationship between outsourcing and firm performance (e.g, Jiang, Belohlav, and Young 2007), other studies report a negative relationship (e.g, Weigelt 2009). Still others find no significant effect of outsourcing on performance (e.g, Gilley and Rasheed 2000). Empirical research that reconciles these inconsistent findings by uncovering the conditions under which the performance implications of outsourcing are negative versus positive is missing. Hence this research fills the gap in the current literature by focusing on effects of outsourcing management strategy on the performance of Chevron Nigeria limited.

METHODOLOGY

Research Design

This is an exploratory research design to determine the nature of the effect of outsourcing strategy on the profitability of Chevron Nigeria Limited over a time span covering 15 years.

Method of Data Collection

Secondary data on the outsourcing of particular activities (information technology, maintenance and supplies) were obtained from the official balance sheets data of Chevron Nigeria Limited supplementary annual report.

Data Requirement

For the purpose of this study, the required data were:

Total cost of the outsourced activities from 1999-2013.

Total organizational profitability from 1999-2013

Method of Data Analysis

The Pearson's correlation coefficient was employed in analyzing the statistical data. The Pearson Product-Moment Correlation is a measure of the strength and direction of association that exists between two continuous variables measured on at least an interval scale. Correlation, which is closely related to but conceptually very much different from regression analysis, is aimed at measuring the strength or degree of linear association between the dependent and independent variables (Gujarati, 2003). Such relationship exists in three forms; a strong positive relationship, a weak positive relationship and no relationship. The Pearson's *r* ranges from -1.0 to 1.0, where a negative coefficient indicates inverse relations between the variables.

The formula is given as:

$$r = \frac{\sum XY - \frac{\sum X \sum Y}{n}}{\sqrt{\left[\sum X^2 - \frac{(\sum X)^2}{n}\right]\left[\sum Y^2 - \frac{(\sum Y)^2}{n}\right]}}$$

A value of r is interpreted as follows:

A coefficient of 0 indicates that the variables are not related.

A negative coefficient indicates that as one variable increases, the other decreases.

A positive coefficient indicates that as one variable increases the other also increases.

Identification of Variables

X = This is the total expenditure on outsourced activities from 1999 to 2013

Y = This is the total profitability from 1999 to 2013

N = This is the total number of years considered.

DATA PRESENTATION AND ANALYSIS

This section provides the data presentation, analysis and test of the relevant hypothesis of the study. The analyses were conducted in order of priority.

Table 1: Yearly Expenditures on Outsourced Activities and Total Organizational Profitability

No. of Years.	Total Expenditures of Outsourced Activities ($)	Total Profitability ($)
1999	20,639,000	334,014,752
2000	22,837,000	361,745,374
2001	27,039,000	375,045,073
2002	25,910,000	478,325,775
2003	29,606,000	492,130,075
2004	35,640,000	514,593,530
2005	38,231,000	534,961,810
2006	47,650,000	550,268,518
2007	55,000,000	569,906,797
2008	61,000,000	599,966,235
2009	64,000,000	654,075,773
2010	72,270,000,	714,940,901
2011	75,000,000	760,947,948
2012	80,689,000	891,498,813
2013	87,380,000	945,442,139

Source: Chevron Nigeria Limited Annual Report.

Correlation Analysis

A summary and interpretation of the Pearson Correlation Coefficients result came first which was closely followed by the test of hypothesis.

Table 2: Summary of Correlation Coefficient Output for Outsourced Activities and Total Profit

	Outsoured Activities	Total Profit
OUTSOURED ACTIVITIES Pearson Correlation (r)	1.000	.985*
Sig. (2-tailed) (p)	-	.002
N	15	15
TOTAL PROFIT Pearson Correlation (r)	.985*	1.000
Sig. (2-tailed) (p)	.002	-
N	15	15

**. Correlation is significant at the 0.01 level (2-tailed)

*. Correlation is significant at the 0.05 level (2-tailed)

The results from the analysis of this study are presented in a matrix as can be found in table 2 above. Nevertheless, the table above presents the Pearson Correlation Coefficient, the significance value and the sample size that the calculation is based on. The *r*-value indicates the strength and direction (±) of the correlation. The "*" means we can reject the null hypothesis (Ho). The p-value is the probability that we can see an *r* -value of this size just by chance.

Test of Hypothesis

The hypothesis tested is restated below:

H_o: There is no nature of effect of outsourcing strategy on the profitability of Chevron Nigeria Limited.

H_i: There is nature of effect of outsourcing strategy on the profitability of Chevron Nigeria Limited.

The basis for the acceptance or rejection of the hypothesis is based on the following assumptions:

H_o: r = *0 [There is NO NATURE OF EFFECT]*

H_i: r ≠ *0 [There is NATURE OF EFFECT]*

Table 3: Summary of Pearson Product-Moment Correlation Coefficient Showing the Nature of the Effect of Outsourcing Strategy on the Profitability of Chevron Nigeria Limited

Variables	Mean Score	SD	VIF	TOL	t-cal	t-tab	df
Outsourced activities (N=15)	8.62	4.41	1.00	1.00	0.985	0.19	15
Profitability of Chevron Nigeria	13.08	6.52					

Source: Correlation Output **(t(15)=0.985, p<.05)**

DISCUSSION OF FINDINGS

From the Pearson correlation coefficient in table 2, r is 0.985, and is statistically significant at ($p < 0.0005$). Arising from the above, it implies that outsourcing strategy has a strong, positive effect on the profitability of Chevron NIGERIA PLC, which was statistically significant ($r = .985$, $n = 15$, $p < .0005$).

The result as summarized in table 3 above showed that the calculated Pearson Product Correlation value of 0.985 is greater than the table value of 0.19. Therefore, the tested null hypothesis is rejected and the alternative hypothesis which states that there is nature of outsourcing strategy on the profitability of Chevron Nigeria Limited is accepted. This is in line with the study by Amiti and Wei (2006) which reported that both service outsourcing and material outsourcing have a positive and significant effect on organization profitability.

FINDINGS AND POLICY IMPLICATIONS

The finding which revealed that outsourcing strategy has a positive effect on the profitability of Chevron Nigeria Limited is imbued with policy implications. Most probably, the Management of Chevron Nigeria Limited spent money and delegated its authority to other organisations, but the positive result indicated that such decision was fundamental to robust profitability performance of Chevron. However, the Management may consider the option of constant monitoring of the company's contractors to ensure compliance with its core values.

There is the implication of some review and adjustment in long-term goals and structure of the focused organisation if profitability performance is to be sustained.

CONCLUSIONS AND RECOMMENDATIONS

Following the results from the test of hypothesis and data analyses, we conclude that outsourcing strategy of Chevron has a positive effect on the organizational profitability. Therefore, the effective and efficient use of outsourcing strategy in a firm enhances the profitability of the organization.

The following recommendations are therefore made:

- Successful implementation of an outsourcing strategy has been credited with helping to cut cost, increase profitability and productivity, therefore organizations should embrace the outsourcing strategy to enhance overall

performance.

- Companies that outsource should continue to monitor the contractor's activities and establish constant communication.

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